

No. 9746

IN THE
United States Circuit Court of Appeals
FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

J. LESLIE MORRIS COMPANY, INC., a corporation,

Appellee.

BRIEF FOR THE APPELLEE.

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BRIEF FOR THE APPELLEE.

Opinion Below.

The memorandum opinion of the District Court [R. 32-36] is unreported.

Jurisdiction.

The statement as to the jurisdiction of this Court contained in appellant's opening brief is accepted by appellee.

Question Presented.

Whether sales of rebabbitted connection rods by appellee were taxable under section 606(c) of the Revenue Act of 1932, which imposed a tax upon automobile parts "sold by the manufacturer, producer, or importer" thereof.

Statutes, Regulations and Rulings.

The applicable statutes, regulations and rulings involved will be found in the appendix to this brief.

Statement.

The case was tried to the court without a jury upon evidence consisting of two witnesses offered by appellee and numerous exhibits offered by each of the parties. The court rendered a memorandum opinion [R. 32-36] and findings of fact and conclusions of law [R. 36-60] in favor of appellee.

The practice of rebabbitting worn or damaged automobile connecting rods has existed for many years prior to the enactment of the Revenue Act of 1932. Originally the individual repair shops performed this operation, in fact this is true in certain instances today. However, because of the volume of business and the expense involved it has become the practice for this work to be performed by repair shops specializing in this work.

A connecting rod is the mechanical means by which the piston is connected to the crankshaft. It transmits the energy created by the explosion of gasoline vapor in the cylinder to the crankshaft. [R. 89.] In order to minimize the wear created by the friction there must be bearings provided at each end of the rods. At the large or lower end of the connecting rods there are thin layers of babbitt metal which separate the rod from the crankshaft journal which absorbs the wear. [R. 109.] The rods are divided at the center of the large end to permit installation on the crankshaft journal. The lower part or cap, being fastened to the upper part or shank, with two bolts and nuts. [R. 108.]

During the period herein involved the appellee owned plants in New York, Columbus, Chicago, Los Angeles, Portland and Seattle. [R. 163.] The Los Angeles and Chicago plants were the largest. [R. 164-165.] It is

the practice of automobile repair men to send worn or damaged rods to jobbers in exchange for rebabbitted rods of the same type. The jobbers in turn send these rods to appellee or others in the same business to have them rebabbitted or exchanged for rods of the same type which have previously been rebabbitted. [R. 102-103.]

In order to prevent delay which would result if each customer's rods were rebabbitted and returned, appellee has acquired a stock of used rods which have been rebabbitted and placed on the shelf for immediate exchange for worn or damaged rods of the same type. [R. 166.]

Ninety-five per cent of the rods sold by appellee were used rods sent in by jobbers in exchange for rebabbitted rods or to be rebabbitted and returned. The remaining five per cent were received from dealers in used rods or were purchased from automotive representatives. [R. 120.]

In order to economically handle the large volume of business which appellee enjoyed it was necessary to maintain shops utilizing considerable machinery. Appellant devotes much space in the opening statement in it's brief to the discussion of the number of employees, the machinery used and the process through which the rods passed. Appellee contends that the number of employees, amount of machinery and process has no bearing on the taxability of the parts sold. That the test of taxability is whether this appellee was or was not a manufacturer or producer within the meaning of section 606(c) of the Revenue Act of 1932.

ARGUMENT.

I.

The Rebabbitting of Used Second Hand Connecting Rods Is Not the Manufacture or Production of Connecting Rods, But Is Only the Repair, Restoration or Reconditioning Thereof.

(a) MANUFACTURING OR PRODUCTION CONSISTS OF THE APPLICATION OF LABOR OR SKILL BY HAND OR MACHINERY SO THAT AS A RESULT THEREOF A NEW, DIFFERENT AND USEFUL ARTICLE OF COMMERCE IS PRODUCED.

In this case appellee seeks a refund of manufacturer's excise taxes paid by it upon the sale of used, second hand automobile connecting rods which it had rebabbitted. All of the connecting rods sold by appellee were parts of automobile engines and over ninety-five (95%) per cent of them had been used and as a result of such use had become worn or damaged. The evidence by the testimony of J. Leslie Morris which was uncontradicted is that the connecting rods sent to appellee's plant for rebabbitting could continue to operate in an internal combustion engine. [R. 123.] It was further testified by Mr. Morris that the rebabbitting was the building up of the bearing so that it would operate more efficiently. [R. 123.] In fact the witness stated [R. 123]:

"Preserve the oil pressure, and things of that sort. It will function. In fact, I suppose 95 per cent of the automobiles that pass this building right now, the bearings are too loose, but they are still running just the same."

The appellee herein merely repaired used connecting rods which had been worn or damaged through use as component parts of automobile engines. The Court made a finding of fact to the effect that appellee had not manufactured any connecting rods. In paragraph III of the findings of fact the Court found in part [R. 39]:

“ . . . All of said connecting rods were manufactured by persons, firms or corporations other than plaintiff and before their acquisition by plaintiff had been used as operating parts for automobile motors, and by reason of such use the babbitt metal lining constituting a part of said connecting rods had become worn, chipped, roughened and otherwise impaired; . . . ”

Unrefuted testimony was to the effect that appellee never manufactured any new rods and did not have the equipment to manufacture them. [R. 98.] The same evidence also established that appellee never removed the manufacturer's identification marks from any rods rebabbitted by it or put on any identification marks of its own. [R. 99.] The method of acquisition and repairing of the connecting rods was fully set forth in the record. (Plaintiff's Exhibits 1 to 32.)

If appellee's rebabbitting process commenced with a connecting rod and ended with a connecting rod, it is obvious that nothing has been manufactured or produced. No new article of commerce has been produced by the process, no new thing has been brought into existence. When the rebabbitter commenced his work he had a connecting rod and when his work was completed he still had the same connecting rod. It makes no difference how long it took him to do the work, or how many different

pieces of machinery he employed in the process, or whether he worked alone in a small shop, or whether he employed many other workmen in a large plant, or whether after the process was completed, he immediately reinstalled the connecting rod in the automobile from which it was taken, or whether he laid it upon a shelf and subsequently exchanged it for another used, second-hand connecting rod of the same type. The question is, "What did the rebabbitter do?" Did he produce or manufacture a new article? Did he merely repair an article which someone had previously produced or manufactured? Manifestly, he has repaired a connecting rod. His work commenced after the manufacture or production of that connecting rod had long since been completed and the rod had actually seen service as an operating part of an automobile engine.

The meaning of the words, "manufacturer" and "producer" is clear. A manufacturer is one who makes something new, according to Webster's New International Dictionary:

"1. To make (wares or other products) by machinery or by other agency; as to manufacture cloth, nails, glass, etc., to produce by labor, esp., now, according to an organized plan and with division of labor, and usually with machinery."

2. To work, as raw or partially wrought materials, into suitable forms for use, as to manufacture wool, iron, etc.

3. To fabricate; to invent; also, to produce mechanically;

The terms manufacture and produce must be compared with the word "repair", a word which is repugnant to and exclusive of manufacture or produce.

To repair, defined by Webster's New International Dictionary, *is to restore to a sound or good state after decay, injury, dilapidation, or partial destruction; as to repair a house, a road, a shoe, also to renew, revive or rebuild.*

The principles involved in this case were recognized and stated by the court in *Thurman, Collector v. Swisshelm* (C. C. A. 7), 36 Fed. (2d) 350. In that case the taxpayer dealt in automobiles. They bought completed Ford automobiles from the Ford Motor Company or its agents. They bought from the Ames Company automobile bodies so constructed that they would fit the Ford chasses. They would remove the Ford bodies from the automobiles and replace them with the Ames bodies. The question was whether the taxpayer by that process became the manufacturer or producer of automobiles so as to become liable for the manufacturer's excise tax on the automobiles. The court held that they were not manufacturers or producers of automobiles. The court then distinguished the case of *Klepper v. Carter*, 286 Fed. 370, which is cited by appellant as authority, and said l. c. 351:

"The facts are different in that there was no truck figured in the transaction until the parts had been assembled and connected; while here appellees bought the completed automobile upon which the tax had already been paid."

The principles underlying the *Swisshelm* case is in no-wise different from the case at bar. *Swisshelm* commenced his process with automobiles completely manufactured and tax paid by the manufacturer; the appellee in

this case commenced its work with connecting rods previously manufactured and tax paid by a manufacturer. When Swisshelm finished his process, he still had an automobile—he *had created nothing new*; when appellee in this case completed its process, it still had connecting rods—it *had created nothing new*.

The courts have been frequently called upon to define, and apply the definition of, manufacture. A leading and often cited case is *Hartranft v. Wiegmann*, 121 U. S. 609. The issue in that case concerned the rate of duty to be levied upon certain shells depending upon whether they were or were not “manufactured”. The question involved and the facts are stated in the opinion by Mr. Justice Blatchford, as follows, l. c. 613-14:

“The question is whether cleaning off the outer layer of the shell by acid, and then grinding off the second layer by an emery wheel, so as to expose the brilliant inner layer is a manufacture of the shell, the object of these manipulations being simply for the purpose of ornament, and some of the shells being afterwards etched by acids, so as to produce inscriptions upon them. It appears that these shells in question were to be sold for ornaments, but that shells of these descriptions have also a use to be made into buttons and handles of penknives; and that there is no difference in name and use between the shells ground on the emery wheel and those not ground. It is contended by the government that the shells prepared by the mechanical or chemical means stated in the record, for ultimate use, are shells manufactured, or manufacturers of shells, within the meaning of the statute.”

The conclusion of the court and the reasoning supporting it are set forth in the following excerpt from the opinion, l. c. 615:

“We are of the opinion that the shells in question here were not manufactured, and were not manufactures of shells, within the sense of the statute imposing a duty of 35 per centum upon such manufacturers, but were shells not manufactured, and fell under that designation in the free list. They are still shells. *They had not been manufactured into a new and different article, having a distinctive name, character or use from that of a shell.* The application of labor to an article, either by hand or by mechanism, does not make the article necessarily a manufactured article, within the meaning of that term as used in the tariff laws. Washing and scouring wool does not make the resulting wool a manufacture of wool. Cleaning and ginning cotton does not make the resulting cotton a manufacture of cotton. In ‘Schedule M’ of Section 2504 of the Revised Statutes, page 475, 2nd Edition, a duty of 30 per cent *ad valorem* is imposed on ‘coral, cut or manufactured’; and, in Section 2505, page 484, ‘coral, marine, unmanufactured’, is exempt from duty. These provisions clearly imply that, but for the special provisions imposing a duty on cut coral, it would not be regarded as a manufactured article, although labor was employed in cutting it. In *Frazee v. Moffit*, 20 Blatchf. 267, it was held that hay pressed bales, ready for market, was not a manufactured article, although labor had been bestowed in cutting and drying the grass and baling the hay. In *Lawrence v. Allen*, 48 U. S. 7 How. 785, it was held that india rubber shoes, made in Brazil, by simply allowing the sap of the india rubber tree to harden upon a mold, were a manufactured article because it

was capable of use in that shape as a shoe, and had been put into a new form, capable of use and design to be used in such new form. In *United States v. Potts*, 9 U. S. 5 Cranch 284, round copper plates turned up and raised at the edges from four to five inches by the application of labor, to fit them for subsequent use in the manufacture of copper vessels, but which were still bought by the pound as copper for use in making copper vessels, were held not to be manufactured copper. In the case of *United States v. Wilson*, 1 Hunt's Merchants' Magazine 167, Judge Betts held that marble which had been cut into blocks for the convenience of transportation was not manufactured marble, but was free from duty, as being unmanufactured.

"We are of the opinion that the decision of the circuit court was correct. But, if the question were one of doubt, the doubt would be resolved in favor of the importer, 'as duties are never imposed on citizens upon vague or doubtful interpretations'. *Powers v. Barney*, 5 Blatchf. 202; *U. S. v. Isham*, 84 U. S., 17 Wall. 496, 504; *Gurr v. Scudds*, 11 Exch. 190, 191; *Adams v. Bancroft*, 3 Sumn. 384."

In *Anheuser-Busch Brewing Association v. U. S.*, 207 556, the plaintiff sued to recover certain import duties which it had paid on corks designed for use in bottling beer. Under the act there involved plaintiff was required to prove as the basis of its refund or "drawback" that the corks involved were not manufactured corks, but merely materials imported to be used in the manufacture of corks in the United States. The evidence showed that the corks when imported into this country from Spain had already been cut by hand to the required size. It was

further shown that in such condition, however, they were not suitable for use in bottling beer because they would not retain the gas in the bottle and because they would impart a cork taste to the beer, thereby making it unmarketable and unfit for use. After importation, however, the corks were subjected in the brewing company's plant to various processes and treatment consuming several days of time, during which the corks were treated, processed, sealed and coated so as to render them useful for the intended purpose. The court found that the process to which the corks were subject did not constitute manufacture; that the corks were manufactured before they were imported and that the brewing company was not entitled to its refund. In the opinion by Mr. Justice McKenna it is said, l. c. 559:

“The corks in question were, after their importation, subject to a special treatment which, it is contended, caused them to be articles manufactured in the United States of ‘imported materials’ within the meaning of Section 25. The Court of Claims decided against the contention and dismissed the petition. 41 Ct. Cl. 389.

“The treatment to which the corks were subjected is detailed in Finding 3, inserted in the margin.

“In opposition to the judgment of the Court of Claims counsel have submitted many definitions of ‘manufacture’, both as a noun and a verb, which, however applicable to the cases in which they were used, would be, we think, extended too far if made to cover the treatment detailed in Finding 3 or to the corks after the treatment. The words of the statute are indeed so familiar in use and meaning that they are confused by attempts at definition. Their first sense as used is fabrication or composition,—a new article

is produced of which the imported material constitutes an ingredient or part. When we go further than this in explanation, we are involved in refinements and in impractical niceties. Manufacture implies a change, but every change is not manufacture, and yet every change in an article is the result of treatment, labor, and manipulation. But something more is necessary, as set forth and illustrated in *Hartranft v. Wiegmann*, 121 U. S. 609, 7 Sup. Ct. Rep. 1240. *There must be transformation; a new and different article must emerge, 'having a distinctive name, character or use'.* This cannot be said of the corks in question. A cork put through the claimant's process is still a cork."

In *Hughes v. City of Lexington*, 277 S. W. 981, the appellant was a corporation engaged in the business of making and selling ice cream. Nevertheless, the City of Lexington contended that the corporation was not engaged in manufacturing within the meaning of the state statutes which exempt from city taxes machinery, material and supplies used in manufacturing. In the opinion by Clark, C. J., it is said, l. c. 982:

"The sense in which the term is here used, as well as the purpose intended to be accomplished by the act, is quite plain. Obviously, the term 'engaged in manufacturing' was not employed in any technical sense, but must be accorded its ordinary meaning as commonly understood. And, while incapable of exact definition, nevertheless it is true, as was stated in several of the above cases, that according to common understanding and generally speaking, manufacturing consists in the application of labor or skill by hand

or machinery to material so that as a result thereof, a *new, different* and useful article of commerce is produced.”

The foregoing cases emphasize and reiterate the principle that whether a given process constitutes manufacturing depends upon whether the process results in the creation of a new thing. If that which emerges at the conclusion of the process is the same thing which entered the process at its beginning, notwithstanding some labor and some new materials have been expended upon it during the process—in other words, if the thing retains its identity during the course of the process and after it is completed—then no manufacturing or production has occurred. If the article before the process commenced was a cork and it emerged from the process still a cork, there has been no manufacture. By the same token, the principle as applied to the case at bar leads inevitably to the conclusion that since the connecting rods in question did not lose their identity during the rebabbiting process, but were connecting rods when they entered plaintiff’s plant and were still connecting rods when they left the plant, there was no manufacture.

(b) THE MERE REPAIR, RESTORATION OR RECONDITIONING OF AN ARTICLE DOES NOT CONSTITUTE MANUFACTURING OR PRODUCTION.

An essential distinction must be preserved between manufacture which, as above shown, results in the creation of a new article, and mere repair which results only in the restoration of partial injury but does not create a new article. When an article which consists of several component parts sustains wear or suffers injury to one of

those parts, the plain economics of the situation dictate that the injured part, if possible, shall be replaced or repaired, rather than that the entire article shall be wastefully discarded. A man may drop his watch and break the balance staff so that its usefulness as a timepiece is, for the time being, destroyed. But in such a case the owner does not throw his watch away and buy another. Instead, he takes it to a skilled mechanic who replaces the broken or damaged part and restores the watch to its former condition of usefulness. No one would argue in such a case that the jeweler had manufactured a watch. The admitted fact is that the owner took a watch to him. True, the watch was damaged and would not operate, but it was, nevertheless, a watch. After the jeweler had repaired the balance staff, it was still a watch—the same watch. It never lost its identity as a watch. Such is the process of repair or restoration as distinguished from the process of manufacture.

The distinction between repair or restoration, on the one hand, and manufacture or construction, on the other hand, is often called in question and decided in patent cases.

Perhaps the leading case in this field is *Wilson v. Simpson*, 9 How. 109. In that case the owner of a patented planing machine had repaired or reconditioned his machine by placing therein certain new parts, particularly the knives or cutting tools which were the important operative agency of the machine or, as it is sometimes said,

the ultimate effective tool. Notwithstanding the fact that the cutting tools were the most vital and important part of the machine and did the very work for which the machine was designed, the court had no difficulty in finding that their replacement constituted only repair of the machine and not manufacture or production of a new machine so as to infringe the patent. In the opinion by Mr. Justice Wayne it is said, l. c. 123:

“But it does not follow, when one of the elements of the combination has become so much worn as to be inoperative, or has been broken, that the machine no longer exists, for restoration to its original use, by the owner who has bought its use. When the wearing or injury is partial, then repair is restoration and not reconstruction.

“Illustrations of this will occur to anyone, from the frequent repairs of many machines for agricultural purposes. Also from the repair or replacement of broken or worn-out parts of larger and more complex combinations for manufactures.

“In either case, repairing partial injuries, whether they occur from accident or from wear and tear, is only refitting machine for use. And it is no more than that, though it shall be a replacement of an essential part of a combination. It is the use of the whole of that which a purchaser buys, when the patentee sells to him a machine; and when he repairs the damages which may be done to it, it is no more than the exercise of that right of care which everyone may use to give duration to that which he owns, or has a right to use as a whole.”

In *Hess-Bright Mfg. Co. v. Bearing Co.*, 271 Fed. 350, the court considered a case involving the alleged infringement of a patent upon a ball bearing. The bearing consisted of a groove of a certain depth with balls exactly fitting it. The vendee of this patented bearing reground or smoothed up the groove, an operation which necessarily resulted in somewhat enlarging the groove. This necessitated installing larger balls to fit the enlarged groove. The question was whether or not the owners of the bearing had constructed a new bearing so as to infringe the patent or whether he had merely repaired his bearing. The court found that there was no manufacture involved in the process and that the patent had not been infringed. In the opinion by Dickinson, district judge, it is said, l. c. 351:

“Council for plaintiff does not, of course, formulate the claim of right as defendant states it. He does not deny to the vendee of plaintiff the right to repair. What he does deny is any right, by using plaintiff’s bearing as a model, to make a new bearing from the raw material of the old one. It is obvious that all this is nothing more than opposing statements of the effect of what the defendant had done. The defendant calls it the repair of old bearings. The plaintiff calls it new construction or reconstruction. Omitting the name properly to be applied to what was done, the fact finding is made that what was done was the regrinding of the groove of old bearings, and, when required, the substitution of new balls to fit the grooves enlarged by the regrinding.

“The dividing line between repairs and a making over cannot be verbally located. What has been done can with more or less confidence be pronounced to be one or the other, but neither the one nor the

other can be defined. The judgment pronounced must in consequence partake of the *ipse dixit* or rescript character. A further consequence is that the adjudged cases provide us with little for our guidance. With no thought of finding a better mode of expression for the clearly presented views of counsel for plaintiff, it may be premised that a feature of the patented bearing is the metallic pathway provided in the form of a groove, which calls for the use of balls of a certain size. The nicety of adjustment required can be most emphatically expressed by the statement that the unit of measurement employed is the ten-thousandth part of an inch. This groove may, from use or abuse, be in need of being remade by regrinding. The lightest repolishing, almost, is such.

“The argument that this is not repair, but a new construction, may be thus expressed: A bearing with a groove of a certain depth, with balls exactly fitting it, is sold by the plaintiff to A. Another bearing, with a different groove, calling for the next larger size balls, is sold to B. The first vendee smooths up the groove in his bearing, thus adopting it to the next larger size of balls. By so doing he has not repaired the bearing sold to him, but out of the material in this old bearing he has made a new one, which is not his old bearing, but a different bearing of the B type. In other words the old A bearing has lost its identity by destruction, and a new bearing, B, has been made. In a sense this is, of course, true; but it is only true in a sense. Identity is not lost by a mere change in size. The rule of which we are in search is a practical rule for the guidance of practical men in practical business. What the patentee sells is a concrete thing. It is a bearing. As long as it remains the bearing of the patent, it is what the patentee sold. The moment it becomes something else the patentee

is not concerned with it. The groove of the patent is still the groove of the patent, although enlarged. It no more loses its identity by enlargement than a river does by the change of the volume, due to the flow and ebb of the tide, or by the shoaling or deepening of its channel by the wash of its current.

“The balls are no part of the groove, but something used with it. There is no thought of denying the right of a vendee to repair balls. His right is not limited to any size of ball. The balls may be replaced without thought of infringement of any patent right. To deny vendee the right to smooth up a groove is to deny him all right to make repairs to the patented features of what was sold to him. The right cannot be limited to the use of the same balls as before. The only limitation is that he may repair, but cannot make a new bearing out of the material of the old. What is the one and what the other the facts of each case must determine. The line, as before observed, is most difficult to draw in words of description; it is by no means so difficult to draw in fact.

“In the instant case our fact finding is that what defendant has done is to make repairs, and that it has not infringed upon the patent rights of plaintiff. The name given to anything is not necessarily indicative of what the thing is. A fact upon which defendant lays much stress has some interest as a coincidence, but no other value. The fact referred to is that the plaintiff itself did what the defendant has done, and the department in charge of such work was called by plaintiff its ‘Repair Department’. We attach as little importance to the distinction between repairing and selling second-hand bearings after they have been repaired.”

In *Foglesong Machine Co. v. Randall Co.* (C. C. A. 6), 239 Fed. 893, the defendant, being the owner of a patented machine for the stuffing of horse collars, was accused of infringing the patent by making certain repairs upon the machine. The court found that certain parts of the machine were perishable in that they were subject to greater wear than other parts. In that connection the court said, l. c. 895:

“The question for decision is: Did the defendant repair or reconstruct the machine which it purchased from the Grand Rapids Company? In supplying a new hopper, stuffing rod nose, and disc, the defendant merely returned to use the injured or lost portions of the mechanism. This constitutes repairing, and not reconstruction.”

At another point the court said, l. c. 896:

“The machine was not so broken and worn out as to require replacement. The wear and injury were but partial. Under such circumstances, repair is not reconstruction, but restoration, that the mechanism may be kept up to the full performance of its duty.”

In *Goodyear Shoe Machine Co. v. Jackson* (C. C. A. 1), 112 Fed. 146, it is said in the opinion by Colt, C. J., l. c. 151:

“Where the patent is for a machine, which commonly embraces the combination of many constituent elements, the question of infringement by the purchaser will turn upon whether the machine is only partially worn out or partially destroyed, or is entirely worn out, and so beyond repair in a practical sense. In the case of a patent for a planing machine composed of many parties it was held that the re-

placement of the rotary knives, 'the effective ultimate tool' of the machine, was repair, and not reconstruction, *Wilson v. Simpson*, 9 How. 109."

A further statement of the principle involved, together with a citation of many cases, is found in *Miller Hatcheries v. Incubator Co.* (C. C. A. 8), 41 Fed. (2d) 619.

In *State v. J. J. Newman Lumber Co.* (Miss.), 59 So. 923, the distinction between manufacture and repair is clearly stated by the Supreme Court of Mississippi as follows, l. c. 926:

"A reasonable definition may be given to 'manufacturing' (Century Dictionary) as the system of industry which produces manufactured articles, and to 'manufacture' as the production of articles for use from raw or prepared materials, by giving to these materials new forms, qualities, and properties, or combinations, whether by hand labor or machinery, used more especially of production in a large way by 'Repair' is to make whole or restore an article or thing to its completeness. In the general knowledge of the affairs of business and life, it will hardly be difficult to class those persons who are engaged in such employment."

Applying the principles announced and reiterated in the foregoing cases to the facts of the case at bar, it is clear that the injury to the used, second-hand connecting rods which the plaintiff acquired and rebabbitted was but partial. Only the babbitt lining was injured or destroyed. They were not "entirely worn out, and so beyond repair in a practical sense" (*Goodyear Shoe Machinery Co. v. Jackson*, 112 Fed. 146, 151), is conclusively proved by the fact that the plaintiff did restore them to their former

condition of usefulness by the simple expedient of rebabbiting them.

The physical facts speak for themselves. This Court has before it a box of connecting rods in various stages of rebabbiting. These exhibits themselves are the most eloquent testimony obtainable that the rods before rebabbiting were not entirely worn out and were not beyond repair in any sense, but had sustained only partial wear or injury. These rods were not “junk”, and had not been discarded by their former owners as is contended by the appellant. On the contrary, they had been carefully preserved and had been sent to this plaintiff either directly or through jobbers so that they might be rebabbitted or exchanged for other rods of a similar type which had already been rebabbitted.

J. Leslie Morris, testifying for the plaintiff, when asked what percentage of the connecting rods were procured from jobbers, stated [R. 119]:

“A. Approximately 95 per cent.”

If these connecting rods were so far worn out and so beyond repair that they ceased to have any value over and above the melting pot value of the metal contained in them, why did appellee value them as high as \$12.00 each [R. 113], when the top price for that kind of scrap steel was \$11.00 a ton?

There was no evidence that the used, second-hand connecting rods which the plaintiff rebabbitted were, prior to the rebabbiting, so worn out and beyond repair that they had ceased to be connecting rods. On the contrary, under the undisputed evidence in this case, it is conclusively proved and established that these connecting rods had a

commercial value to the plaintiff and to other concerns engaged in the rebabbitting business far in excess of their “junk value”. It is obvious that the comparatively great commercial value of used rods in excess of the melting pot value of the metals contained therein is due entirely to the fact that these rods may be restored to their former condition of usefulness and mechanical efficiency by a process of repair. This is the principle which underlies the decision of the Supreme Court in *Cadwalader v. Jessup & Moore*, 149 U. S. 350. In that case the Supreme Court was called upon to decide whether certain imports of old india rubber shoes were dutiable as crude india rubber or as articles composed of india rubber. The shoes were so worn as to be beyond repair and for that reason they had ceased to be shoes and were valuable only for the rubber which they contained. It is said in the opinion by Mr. Justice Blatchford at page 354:

“The uncontradicted testimony is to the effect that the only commercial use or value of the old india rubber shoes, or scrap rubber, or rubber scrap in question, is by reason of the india rubber contained therein, as a substitute for crude rubber; that the old shoes were of commercial use and value only by reason of the india rubber they contained, as a substitute for crude rubber, *and not by reason of any preparation or manufacture which they had undergone*; that they could not fairly be called ‘articles composed of india rubber’, and as such dutiable at 25 per centum *ad valorem*; and that, although the shoes may have been originally manufactured articles composed of india rubber, they had lost their commercial

value as such articles, and substantially were merely the material called 'crude rubber'. They were not india rubber fabrics, or india rubber shoes, because they had lost substantially their commercial value as such."

The appellant herein compares the above case to the case at bar, stating that the india rubber shoes had lost their commercial value as such articles, and substantially were the material called "crude rubber". It is agreed that they are correct in reference to the shoes, because they were not imported as used shoes to be repaired, but only for their value as crude rubber. In the instant case the connecting rods are repaired to restore them to their former condition of usefulness. If the appellee had converted the connecting rods into some other automobile part then there might be some color of right in the appellant's contention; in fact, this action would never have been instituted.

The appellant bases great emphasis upon the decision in the case of *Clawson & Bals v. Harrison*, 108 Fed. (2d) 991. In order to get a clear picture of this case it is necessary to refer to the findings of fact and conclusions of law as found by the trial court. This case is not published in the National Reporter System, but may be found in Commerce Clearing House, 1939 Standard Federal Tax Service, Vol. 4, Paragraph 9219.

Clawson & Bals had new connecting rod forgings made for them, which they machined and babbitted. During part of the period covered by their suit, they removed all

marks of identification from rods manufactured by General Motors Corporation and subsidiaries. They also rebabbitted used and second-hand connecting rods. At paragraph 10 of the findings of fact the trial court found:

“Plaintiff kept but one stock with respect to each number and had but one outright price with respect to the rods, irrespective of whether they were produced from entirely new castings or from scrap, and regarded the articles made from scrap as equivalent to any similar products made entirely from virgin metal. The rods made from scrap were in competition with similar products made entirely of virgin metal and were just as serviceable. They were held out for sale and sold on the same basis and under the same warranties as the connecting rods produced from entirely virgin forgings. In other words, plaintiff made no distinction between such connecting rods in the numbering, cataloging, selling, billing, advertising, shipping, labeling, pricing, marketing, quality, warranty, guaranty or otherwise.”

As stated before, Clawson & Bals dealt in three kinds of connecting rods; newly-manufactured ones, rebabbitted rods on which the identification marks had been removed and other rebabbitted rods. They at all times held themselves out as manufacturers, as in truth they were. As manufacturers they paid excise tax on all sales of rods, but did not include as part of the sale price the exchange value of the old rods received as part of the selling price. Later the Government assessed a total of \$54,232.02, representing tax and interest on the additional selling price as represented by the value of the old rods received in exchange. Immediately Clawson & Bals objected on the ground that they were only rebabbitters

of a part of the rods sold by them and that the additional tax paid by them of \$54,232.02 should be refunded as representing the tax on the sale of rebabbitted connecting rods.

It is submitted that the facts in the Clawson & Bals case are entirely different from the facts in the case at bar. Clawson & Bals did manufacture new connecting rod forgings from virgin metal, they removed identification marks from a part of the rods rebabbitted by them, they were manufacturers and held themselves out as such, whereas the appellee herein never manufactured a connecting rod, or held itself out as a manufacturer, never removed any identification marks from the rods and, in fact, never did more than repair used and damaged connecting rods.

The appellant also cites as authority *The King v. Bilt-rite Tire Co.*, 1937 Canadian Law Reports 1, and *The King v. Boulton, Ltd.* (1938), 3 Dominion Law Reports 664. However, it is contended by appellee that our courts must give precedent to the cases decided in our own country and must consider as law the overwhelming authorities therein established before resorting to cases decided in foreign courts.

In view of the uncontradicted testimony in the case at bar that the used, second-hand rods which appellee acquired and rebabbitted by reason of the preparation and manufacture which they had previously undergone, had a commercial value as connecting rods which was far in excess of the junk value of the metals therein contained. It is respectfully submitted that the findings and judgment of the learned trial court were correct and should be affirmed.

Taxing Statutes Must Be Strictly Construed and Should Be So Construed as to Produce Uniformity and Equality in Their Application. Their Provisions Cannot Be Extended by Implication.

There was no dispute at the trial of this case as to the methods employed by the plaintiff in rebabbitting automobile connection rods. In fact the method was covered by a series of 32 pictures and an explanatory statement for each, which were introduced as Plaintiff's Exhibits 1 to 32.

The Government produced no direct evidence whatever that the rebabbitting of connecting rods is a manufacturing process or that the rebabbitting of connecting rods constitutes the manufacture of connecting rods.

Being totally without any direct evidence that rebabbitting is a manufacturing process, the Government apparently attempted to prove its case by the use of a syllogism which runs something like this: All large establishments employing many men, using many machines and turning out a large volume of work, doing business on a large scale and publishing catalogues in which their product is described, are manufacturing establishments; plaintiff has all these characteristics; therefore, plaintiff is a manufacturing establishment. The major premise of this syllogism is, of course, untrue, and the conclusion is, therefore, completely false. Size and extent and volume of business do not constitute the test of manufacture. It is common knowledge that there are many machine shops much larger than plaintiff's which manufacture nothing, but are engaged only in repair work.

If the taxing statute here involved is to be applied and administered by testing whether a company is a manufacturer or a repairman by determining whether it does

business on a large scale or on a small scale, and whether it employs many men or few men, then the administration of the taxing statute will result in the greatest inequality and lack of uniformity. The rebabbitter who sells several thousand connecting rods a month will be taxed because he is large and the rebabbitter who sells only a few connecting rods a month will not be taxed because he is small.

The mere fact that ownership of the connecting rods was vested in the appellee does not affect its status as a repairer. There is nothing to prevent appellee from acquiring title to used connecting rods or other automobile parts and repairing them before offering them for sale. Certainly there is no conflict here between the repairman being also the owner and vendor or only the repairman of the used connecting rods for others.

The true test, and the only test, is whether the rebabbing process itself results in the creation of a new article, or whether it only accomplishes the restoration of an article already created. That is the test which can be applied to every rebabbitter and will result in absolute equality and uniformity of administration of the taxing statute.

In *City of Louisville v. Zinmeister* (Ky.), 222 S. W. 958, 1. c. 959, the Supreme Court of Kentucky said:

“In the recent case of *Lorrillard Co. v. Ross, Sheriff*, 183 Ky. 217, 209 S. W. 39, we held that the word ‘manufacture’, in the sense in which it is employed in the statutes quoted above, does not import the

means or methods employed, or the nature or number of processes resorted to, or the size of the factory or the number of hands it employs, or the value of machinery in use, but the result accomplished, whether the article is manufactured or not.”

It is elementary that taxing statutes are to be construed strictly in favor of the taxpayer. This means that the tax must be based upon express statutory authority and cannot be imposed by implication. In *Hartranft v. Wiegmann*, 121 U. S. 609, it is said in the opinion by Mr. Justice Blatchford, at page 616:

“We are of the opinion that the decision of the Circuit Court was correct. But, if the question were one of doubt, the doubt would be resolved in favor of the importer, ‘as duties are never imposed on a citizen upon vague or doubtful interpretations’. *Powers v. Barney*, 5 Blatchf. 202; *United States v. Isham*, 84 U. S., 17 Wall. 496, 504; *Gurr v. Scudds*, 11 Exch. 190, 191; *Adams v. Bancroft*, 3 Sumn. 384.”

In *Miller v. Standard Nut Margarine Co.*, 284 U. S. 498, it is stated in the opinion by Mr. Justice Butler, at page 508:

“It is elementary that tax laws are to be interpreted liberally in favor of taxpayers and that words defining things to be taxed may not be extended beyond their clear import. Doubts must be resolved against the government and in favor of taxpayers. *United States v. Merriam*, 263 U. S. 179, 188, 29 A. L. R. 1547, 44 S. Ct. 69; *Bowers v. New York & A. Lighterage Co.*, 273 U. S. 346, 350, 47 S. Ct. 398.”

In *Erskine v. United States* (C. C. A. 9), 84 Fed. (2d) 690, 691, it is said:

“Such revenue acts must be construed strictly in favor of the appellant sought to be charged as importer. He is ‘entitled to the benefit of even a doubt.’ Tariff Act 1897, 30 Stat. 151; *United States v. Riggs*, 203 U. S. 136, 1939, 27 S. Ct. 39, 40, 51 L. Ed. 127; *Hartranft v. Wiegmann*, 121 U. S. 609, 616, 7 S. Ct. 1240, 30 L. Ed. 1012; *Miller v. Standard Nut Margarine Co.*, 284 U. S. 498, 508, 52 S. Ct. 260, 76 L. Ed. 422.”

In *Bankers Trust Co. v. Bowers* (C. C. A. 2), 295 Fed. 89, 96, it is said that the construction placed on a statute should avoid unjust consequences unless the act compels such a result. This is particularly true of a taxing statute where absolute uniformity and equality are to be preserved.

In *Alaska Consolidated Canneries v. Territory of Alaska* (C. C. A. 9), 16 Fed. (2d) 256, l. c. 258, it is said in the opinion by Rudkin, C. J.:

“Of course there is a presumption that laws, and especially tax laws, will have a prospective operation only; but there is a like presumption that they are intended to operate uniformly and equally upon all and, in the end, the question is one of legislative intent.”

The contention of the Government that some distinction may be made predicated upon the fact that the appellee is a large operator would seem to be specifically refuted by the case of *Spreckels Sugar Refining Co. v. McClain* (C. C. A. 3), 113 Fed. 244, opinion by Circuit Judge Dallas. In that case the statute imposed an excise

tax on all gross receipts in excess of the sum of \$250,000.00 per annum. A monthly return was required by the law, which did not specifically require anything but an annual payment of tax. The Spreckels Company filed a return for the first month, showing receipts in excess of the sum of \$250,000.00, and it was contended that the law should be construed so as to force the company to pay the tax monthly. The court held that the construction of the act contended for by the Government was "so questionable as to render it inadmissible to impose a duty upon a citizen", citing the *Hartranft* case, and further held that such an inequality in the administration of the law could not be imposed upon the plaintiff simply because the returns were so large that its first monthly return exceeded \$250,000.00. The court said in the opinion, l. c. 247:

"We have already pointed out that it is not necessary to put an interpretation upon this section which might involve such inequality in its administration and, except by necessity, no such interpretation could be justified."

Thus it can be seen that the court weighed the very points which are here urged by the appellant and specifically decided that large size of the plant, number of employees and magnitude of operations would not constitute the test of the application of the statute.

It is a cardinal principle of tax law that any doubt shall be resolved against the taxing authority. To do otherwise in this action would be to work great hardship upon the appellee and controvert all established law on that point.

The Bureau of Internal Revenue has no authority to attempt to amend any congressional act or extend the meaning thereof by regulation. This principle is clearly pointed out by the Supreme Court in *Koshland v. Helvering*, 298 U. S. 441, 446; *Manhattan General Equipment Co. v. Commissioner*, 297 U. S. 129, 134.

Had Congress intended the tax herein involved to attach to the sale of repaired automobile parts such provision would have been put in the Internal Revenue Act of 1932. Failure to put such provision in that act shows clearly that it intended for the tax to attach to the sale of only newly-manufactured parts.

Appellee respectfully submits that, in the public interest, as well as to prevent injustice to this appellee, the judgment of the learned trial court should be sustained to the end that fairness, equality and uniformity in the administration and collection of federal manufacturer's excise tax shall be insured.

Conclusion.

It is submitted that the evidence supports the findings of fact, conclusions of law and opinion of the trial court, and that the judgment should be affirmed.

Respectfully submitted,

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Attorneys for Appellee.

APPENDIX.

Revenue Act of 1932, c. 209, 47 Stat. 169:

Sec. 606. TAX ON AUTOMOBILES, ETC.

There is hereby imposed upon the following articles sold by the manufacturer, producer, or importer, a tax equivalent to the following percentages of the price for which so sold:

* * * * *

(c) Parts or accessories (other than tires and inner tubes) for any of the articles enumerated in subsections (a) or (b), 2 per centum. * * *

Treasury Regulations 46, approved June 18, 1932:

Art. 4. Who is a manufacturer or producer.—As used in the Act, the term “producer” includes a person who produces a taxable article by processing, manipulating, or changing the form of an article, or produces a taxable article by combining or assembling two or more articles.

